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Sneaky But Legal Use Of General Obligation Bonds.

Every time you read an article or see on television that someone was incarcerated for 20 years but later proven innocent, you've got to think, *how are they going to be repaid?* Or you read about a lawsuit against a city for police brutality, civil rights violations, or killing an innocent person—you know there's going to be huge payout.

Perhaps it's Michigan State University, or USC being sued for a faculty member's grotesque misconduct against the school's students while the university sat by doing nothing to avoid rocking their financial boat. There will be monetary damages. These atrocities, each and every one of them, have financial consequences to the cities and institutions that employed the guilty parties. Whether it's a civil ruling or a settlement, money—lots of money—goes to the victims.

Where do these enormous amounts of money come from? Therein lies the problem. The payouts are growing fast. According to Bloomberg, states and municipalities so far in 2018 have raised $1.6 billion, up from $826 million in 2017 and just $281 million in 2016 to pay for legal judgments.

They certainly hadn't budgeted for these expenses. The cash wasn't in the city's treasury. Where did it come from? Sometimes they borrowed it from the municipal bond market. Municipal indebtedness in the form of judgment bonds is growing fast. These bond issues leave state and local governments with decades of interest payments, leading up to the maturity date when they must cough up with the principal.

I'd say these judgment bonds are appropriately named. At least they tell buyers what the bond proceeds are used for. Contrast that with police-related settlements, wrongful death judgments, or payment for dastardly deeds perpetrated by city officials that are paid for by issuing general obligation bonds. This technique is sneaky, but so far legal.

You may think only obscure issuers would deliberately hide the true use of a bond's proceeds—untrue. In August 2018 Dallas issued $58.7 million general obligation bonds (CUSIP: 235219NS7) whose sole purpose was to pay for the lawsuits associated with firefighter and police pay. The total amount needed to settle comes to $235 million so there will likely be more bonds issued. The Official Statement identifies the bonds as refunding and specifically says the debt is for legal settlements.

Wait a minute. Aren't general obligation bonds issued for infrastructure projects like roads, parks, bridges and other capital improvements that serve the municipality and enable it to thrive? Apparently, not any more.

I am appalled at the ability of an issuer to conceal judgment liabilities under their general obligation umbrella. Legal, schmegal—do-it-yourself investors who don't read their municipal bond Official Statements may never know. An investor would have to dig in and find—on page 35 of the Dallas Official Statement—where the city states the true intended use for the bond proceeds. Who's going to do that? Professionals, yes. Individual investors, probably not.

Many investors will be morally outraged if they knew what these general obligation bonds were actually being used for and how the issuer was intentionally conducting such financial slight of hand.

Here are some other judgment bond issuers: Nassau County, New York for a wrongful conviction; Milwaukee, Wisconsin; San Juan Capistrano, CA for a real estate development lawsuit. Los Angeles has been on-again off-again to pay off legal settlements and court judgments against the city.

Although issuing GOs for specific purposes—such as the payment of lawsuits—is legal, I think it is deceptive. Caveat emptor.

Forbes

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Aug 20, 2018

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